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SUBJECT: MADAGASCAR: THE ECONOMIC CONSEQUENCES OF
POLITICAL CRISIS

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¶1. (SBU) Summary: As politicians wrangle for power in Antananarivo, business owners, street vendors, consumers, and the Malagasy population in general are paying a heavy price for the feud. Although the medium and long-term impacts on the economy will depend on rapidity of crisis resolution, short-term damage is already significant. Historical examples and the current pace of negotiations indicate that a solution will not come quickly; thus, the mid-term economic outlook appears grim. The crisis does provide a fresh and urgent opportunity to push the GOM on needed improvements in the investment climate, however. End summary.

¶2. (SBU) According to a study conducted by the leading international financial institutions (IFIs) in Madagascar, direct business losses due to burning and looting in January and February amount to USD 26 million, or close to USD 50 million taking into account the loss of profits and new investments. The study estimates that more than 10,000 people have lost their jobs, not including those that have been laid-off in the garment sector. The curfew which has been in effect for over one month has particularly hurt restaurants and taxi drivers. Almost daily protests have led to the closure of businesses adjacent to protest areas and interrupted the operations of microentrepreneurs. Following the looting of the wholesale distributor MAGRO and other grocery stores January 26, food prices spiked. Although they have begun to decline, distributors and merchants continue to charge higher prices than pre-crisis, impacting the most vulnerable population. Imports of consumer goods have declined by 30 percent with respect to 2008 figures.

¶3. (SBU) The longer the political turmoil continues, the more severe the indirect effects will be, particularly on key export sectors and foreign investment. Following travel alerts by France, the U.S., and the U.K., tourism is already suffering, with hotel occupancy rates of only 10 percent and a 40 percent reduction in international flights. The textile sector, which was already weakened by waning international demand, is receiving fewer international orders and has had to lay off hundreds of workers and close at least one factory to date. Factory owners fear that this trend will intensify if a political solution does not emerge soon. The sector provides almost one-third of formal sector employment; mass lay-offs could further inflame political tension in the capital area. The already poor investment climate has deteriorated further due to the crisis, with Standard and Poor's downgrading Madagascar's sovereign debt from stable to negative.

¶4. (SBU) The government's ability to function has been hampered by the crisis. The lack of a functioning counterpart with which to negotiate is pushing some foreign investors, such as Exxon-Mobil, closer towards the exit door. Exxon, which was already butting heads with President Ravalomanana over concession renewal (reftel), has now

permanently reassigned one of its three expats and has temporarily sent the other two back to the United States. Although the company, which has already invested over USD 60 million in exploration, is considering sending a team to Mahajanga to prepare for possible offshore drilling, the ongoing political crisis could end up being the straw that broke the camel's back. While the two large mining investments (QMM - entered operations last December and Ambatovy - expects to begin production by first quarter 2011) that are already underway are forging ahead, other new entrants are likely to be deterred by falling global mineral prices and the ongoing political uncertainty.

15. (SBU) Government tax revenue is expected to decline this year due to the projected fall in economic activity, particularly because of a loss of import duties and value added taxes. Several business associations, including the Groupement des Entreprises de Madagascar (GEM), have negotiated a two-month tax holiday with the government to enable their members to manage cash flow through the current crisis. Businesses that were looted are looking to the government for other support, such as subsidies, as well. Insurance companies are refusing to pay claims, asserting that the January riots constituted political, not criminal, activity; the GOM may refute that claim publicly in order to support claims for insurance coverage. In response to scapegoating of foreign investors and negative comments made about large mining and agricultural projects by the opposition, the newly-formed American Chamber of Commerce is planning to launch an ad campaign to point out the benefits of foreign investment and the number of jobs at stake, while avoiding direct political messages.

16. (SBU) Comment: If Madagascar's protracted political disputes in 1991 and 2002 serve as models for the current conflict, mid-term economic prospects look grim. GDP growth of negative 12 percent and the damage to Madagascar's international reputation took years to overcome following events in 2002. On the brighter side, this political crisis does provide an opportunity for the GOM to address some of the pre-existing economic governance problems here, including myriad conflicts of interests, a lack of transparency, and the government's failure to provide a level-playing field for investors. We will be pushing for such reforms and arguing against a return to "business as usual" unless we see significant changes in these areas. End comment.

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